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IN THE
Supreme Court of the United States

TEXTRON INC. AND SUBSIDIARIES,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

On Petition for a Writ of Certiorari to the
United States Court of Appeals
for the First Circuit

BRIEF FOR THE COMMITTEE ON TAXATION AND COMMITTEE ON CORPORATE REPORTING OF FINANCIAL EXECUTIVES INTERNATIONAL AS AMICUS CURIAE IN SUPPORT OF PETITIONER

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INTEREST OF THE AMICUS CURIAE

This brief is submitted jointly by the Committee on Taxation and Committee on Corporate Reporting of Financial Executives International (FEI). FEI, a non-profit corporation organized in 1931, is a membership organization for corporate financial managers. FEI's 15,000 members hold policy-making positions as chief financial officers, treasurers, and controllers in over 8,000 corporations throughout the United States and Canada. FEI serves as the leading advocate for the views of corporate financial management, representing both providers and users of financial information. FEI's Committee on Corporate Reporting analyzes and responds, as appropriate, to proposals, statements, pronouncements, and regulations affecting financial accounting and financial statement disclosure issued by the Securities and Exchange Commission, the Financial Accounting Standards Board, the Public Company Accounting Oversight Board, and the International Accounting Standards Board. FEI's Committee on Taxation formulates positions on tax legislation, policies, practices, and rules and regulations, which are then communicated to the executive and legislative branches of the federal government.[1]

This case presents an important issue to FEI's members. Within their respective employer companies,

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[1] In accordance with Rule 37.6, FEI certifies that counsel for a party did not author this brief in whole or in part and that no entity other than FEI, its members, or its counsel made a monetary contribution to the preparation or submission of the brief.

FEI's members are typically responsible for the preparation of financial statements in accordance with generally accepted accounting principles. Those financial statements are subject to audit by the companies' independent auditors. Many of FEI's members are also responsible, directly or indirectly, for the preparation and filing of tax returns and for defense of those returns in response to an IRS audit. FEI's members thus have a strong interest in the outcome of this case and its potential effect on their ability to prepare the most accurate possible financial statements while still retaining work-product protection against disclosure of the mental impressions of their attorneys in potential litigation. Because of that strong interest, FEI filed a brief as *amicus curiae* in the court of appeals, and it believes that it is important to share those views with this Court as well. FEI brings a dual financial reporting and tax perspective to the issues raised in this appeal that it believes will make its views of assistance to the Court.

Counsel of record for the parties received timely notice of FEI's intent to file this amicus curiae brief more than ten days before the due date. The parties have consented to the filing of this brief in letters filed with the Clerk of the Court.

REASONS FOR GRANTING THE PETITION

This case has broad implications for the operations of all publicly held companies. The court of appeals' decision threatens the ability of publicly held companies to develop and protect evaluations of their litigation positions, in tax and other areas, that are necessary for the proper operation of their businesses. Fundamentally, the decision creates an unnecessary

and undesirable conflict between a company's need to take into account material loss contingencies in preparing its financial statements and its legitimate interest in protecting from its adversaries its counsel's mental impressions of litigation prospects. The work-product privilege exists to provide that protection, and this Court should act to preserve its efficacy for public companies that act in the interest of their shareholders and the public by having their counsel prepare litigation analyses.

A. Review is Warranted Because the Court of Appeals' Decision Will Adversely Affect Companies' Ability to Develop and Protect Candid Assessments of Their Litigation Positions in Both Tax and Other Areas

Publicly traded companies must prepare financial statements in accordance with generally accepted accounting principles (GAAP). *See* Securities Act of 1933, § 19(a), 48 Stat. 74, 85, codified as amended at 15 U.S.C.A. §§ 77g, 77aa (Schedule A); Securities Exchange Act of 1934, § 13(b), 48 Stat. 881, 894-95, codified as amended at 15 U.S.C.A. § 78m(b)(2).[2] Under GAAP, a company may be required to accrue a current expense related to material loss contingencies or to disclose information about such loss contingencies

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[2] Today in the United States, GAAP used by publicly traded companies is generally established by the Financial Accounting Standards Board (FASB). Although the SEC has statutory authority to promulgate financial accounting standards, it views accounting standards established by the FASB as authoritative. Sarbanes-Oxley Act of 2002, § 108, Pub. L. No. 107-204, 116 Stat. 745, 768-69.

in its published financial statements. In March 1975, the FASB promulgated Financial Accounting Standard (FAS) No. 5 (Accounting for Contingencies) to establish standards for financial accounting and reporting of all material loss contingencies, including those related to income taxes. Under FAS 5, material loss contingencies include pending or threatened litigation or possible claims and assessments and would include pending or threatened litigation with the IRS. FAS 5 ¶ 33.

In general, an estimated loss from a loss contingency must be accrued if it is probable that a liability has been incurred and the amount of the liability can be reasonably estimated. *Id.* ¶ 8. In some circumstances, the nature of the contingency must be disclosed in financial statements. *Id.* ¶¶ 9, 10. In evaluating whether accrual or disclosure is required under FAS 5, a company should consider, among other things, "the opinions or views of legal counsel and other advisers." *Id.* ¶ 36.

In June 2006, the Financial Accounting Standards Board issued FASB Interpretation No. 48 *Accounting for Uncertainty in Income Taxes* (FIN 48), which specifically addresses the GAAP standards for uncertain income tax positions.[3] Together, FIN 48 and FAS 5 establish a GAAP requirement that public companies

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[3] FIN 48 is an interpretation of FAS No. 109 (Accounting for Income Taxes), which provides general guidance on GAAP accounting for income taxes. As the Summary accompanying FIN 48 acknowledges (at 2), however, FAS 109 "contains no specific guidance on how to address uncertainty in accounting for income tax assets or liabilities."

must evaluate the possible impact of any and all material loss contingencies – both tax and non-tax – on their financial statements.[4]

In auditing the financial statements of a publicly traded company, an independent auditor must follow generally accepted auditing standards. *See* 17 C.F.R. § 210.1-02(d); C.A. App. 40.[5] Under those standards, the primary objective of the audit is to express an

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[4] Effective for accounting periods ending after September 15, 2009, authoritative guidance on U.S. GAAP has been codified in a single FASB publication, the FASB Accounting Standards Codification. According to the FASB, the Codification does not change GAAP for U.S. reporting companies. FAS No. 168 (The FASB Accounting Standards Codification™ and the Hierarchy of Generally Accepted Accounting Principles (June 2009)). The principles of FAS 5 and FIN 48 have been incorporated without material changes into the Codification. *See* Codification §§ 450-20 (Loss Contingencies) and 740-10 (Income Taxes).

[5] U.S. auditing standards traditionally were established by the American Institute of Certified Public Accountants (AICPA). Responsibility for establishing audit guidelines for publicly traded companies has now been assumed by the Public Company Accounting Oversight Board (PCOAB), a non-profit entity created under the Sarbanes-Oxley Act, subject to approval by the SEC. Pub. L. No. 107-204, § 101, 116 Stat. 745, 750-53. The PCAOB adopted interim auditing standards that essentially incorporated AICPA auditing standards as they existed on April 16, 2003, to the extent not subsequently superseded or amended by the PCAOB. PCAOB Release No. 2003-006 (Apr. 18, 2003). Those standards were later approved by the SEC. SEC Rel. No. 33-8222 (Apr. 25, 2003).

opinion on whether a company's financial statements fairly present its financial position, results of operations, and cash flows in conformity with GAAP. PCAOB Interim Auditing Standards (AU), AU § 110.01. The independent auditor must plan and perform the audit to obtain reasonable assurance that the financial statements are free from material misstatement. AU § 110.02. In so doing, the independent auditor must, through the audit, obtain evidence sufficient to afford a reasonable basis to express an opinion regarding the financial statements. *Id.* § 326.

Under generally accepted auditing standards, a company is expected to have adopted policies and procedures to identify and evaluate litigation, claims, and assessments in order to comply with GAAP. *Id.* § 337.02. The company is further expected to provide the independent auditor with a description and evaluation of all litigation, claims, and assessments. *Id.* § 337.05. In addition, in the course of an audit the independent auditor is expected to ask the company to ask its outside counsel to provide the auditor with information concerning litigation, claims, or assessments. *Id.* § 337.06, 337.08-.09. A complete response to those inquiries ordinarily will provide an evaluation of the likely outcome of the case, information that would prove valuable to a litigation adversary.

Thus, in order to prepare their financial statements in accordance with GAAP, and in anticipation that those financial statements will be evaluated by an independent auditor, public companies routinely maintain documents or analyses not unlike Textron's tax accrual workpapers for all manner of pending or threatened litigation. And, as with tax accrual work-

papers, companies share this analysis with their independent auditors so that the auditor can certify that the company has complied with GAAP. Although tax accrual workpapers, like other workpapers or analyses of material loss contingencies, might not be prepared primarily (or even tangentially) "'for use' in litigation" (Pet. App. 23a), they are prepared specifically because of the realistic prospect of identifiable litigation and they necessarily reflect public companies' (and their counsels') candid evaluation of the outcome of such pending or threatened litigation. They are not, as the court of appeals suggested, merely "tax documents" (*id.* at 15a), but are representative of the type of evaluation that is undertaken for a variety of contingencies. *See id.* at 33a (Torruella, J., dissenting). Preserving the confidentiality of such evaluations of litigation outcomes is critical to our adversarial system and lies at the core of the concern addressed by the work-product privilege codified in Fed. R. Civ. P. 26(b)(3).

If the court of appeals' decision in the context of tax accrual workpapers is allowed to stand, its ramifications will extend beyond the tax area. The court's holding will allow a company's non-tax adversaries to obtain discovery of the company's analysis of disputed issues that the company is required to maintain in order to comply with GAAP. Recognizing that this outcome would strike at the heart of the work-product privilege, lower courts confronted with this issue have generally found such materials to be protected.

For example, in *Lawrence E. Jaffe Pension Plan v. Household International, Inc.*, 237 F.R.D. 176 (N.D. Ill. 2006), the district court addressed whether "opinion letters" prepared by the defendant's in-house counsel

and shared with the defendant's independent auditor constituted protected attorney work product. The "opinion letters" summarized pending and threatened litigation against the defendant and its subsidiaries. The court found that the "opinion letters" reflected the attorney's judgment as to defendant's potential liability. *Id.* at 182-83. The court was satisfied that the "opinion letters" were prepared "because of litigation," given that in the absence of pending or threatened litigation, the defendant would have had no need to advise its independent auditor of these matters. *Id.* at 181.

Similarly, documents relating to accounting reserves for products liability litigation were found to be protected attorney work product in *In re Pfizer Inc. Securities Litigation*, No. 90 Civ. 1260 (SS), 1993 WL 561125 (S.D.N.Y. Dec. 23, 1993). The issue arose in a discovery dispute in the context of a class action brought by certain Pfizer shareholders, who alleged that Pfizer violated federal securities laws by failing accurately to disclose the company's financial exposure from product liability claims. The court found that the reserve figures for individual products liability cases reflected the "attorney's professional opinion as to the value of the tort claimant's suit." *Id.* at *4. Even applying the relatively stringent "primary purpose" test for determining whether documents that serve more than one purpose have work product protection, the court found that communications involving individual case reserves constituted opinion work product entitled to nearly absolute protection. *Id.; see also Simon v. G.D. Searle & Co.*, 816 F.2d 397 (8th Cir. 1987) (individual case reserves protected from discovery as opinion work product); *Frank Betz Assocs., Inc. v. Jim*

Walter Homes, Inc., 226 F.R.D. 533 (D.S.C. 2005) (litigation reserve reflected in financial statements and disclosed to independent auditor protected from disclosure as attorney work product).

Like the tax accrual workpapers at issue in this case, documentation prepared by public companies to document and support the financial accounting treatment of non-tax loss contingencies typically reflects the professional judgment of attorneys about potential litigation outcomes and, as such, constitutes work product.

B. Contrary to the Court of Appeals' Decision, Protecting Tax Accrual Workpapers from a Summons by Its Litigation Adversary Would Strike the Appropriate Balance Between the Competing Interests of the Investing Public, the Internal Revenue Service, and the Policies Underlying the Work-Product Privilege

The court of appeals correctly observed that determining the scope of the work-product privilege involves a "balancing of policy concerns." Pet. App. 9a. Here, the issue of whether the Internal Revenue Service can, through its administrative summons power, compel the production of Textron's tax accrual workpapers involves at least three competing interests: the interest of the investing public in having access to accurate financial statements of publicly traded companies, the interest of the IRS in assuring that such companies pay the correct amount of tax, and the interests served by protecting attorney work product. The court of appeals, however, did not strike the appropriate balance among these sometimes competing interests. Indeed, its approach to "balancing" consisted almost

entirely of focusing on the IRS's interest in tax collection.

The interest of the investing public in having access to accurate financial statements of publicly traded companies requires that work product be protected. The integrity of securities markets requires that published financial statements fairly reflect a publicly traded company's financial position. "Corporate financial statements are one of the primary sources of information available to guide the decisions of the investing public." *United States v. Arthur Young & Co.*, 465 U.S. 805, 810 (1984). In providing assurance that a publicly traded company's financial statements fairly reflect its financial position, an independent auditor serves the public interest. *Id.* at 819. Responsible corporate management has a powerful incentive to provide an independent auditor with all information the auditor deems necessary to evaluate the adequacy of a company's financial statements. *See id.* But the court of appeals' holding that the work-product privilege does not apply to tax accrual workpapers creates substantial and unnecessary tension between the public interest in candid communications with an independent auditor and the policy of the work-product privilege to allow a potential litigant to protect its mental impressions and conclusions from its litigation adversary.[6]

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[6] In this regard, we note that the AICPA has observed that current IRS policies regarding requests for tax accrual workpapers could provide a disincentive to full disclosure. In IRS Announcement 2002-63, 2002-2 C.B. 72, the IRS announced changes to the policy of "restraint" noted in *Arthur Young & Co.*, 465 U.S. at 820-21. In an interpreta-

Applying the work-product privilege in this case does not trespass on the proper bounds of the IRS summons authority under 26 U.S.C. § 7602. Through its summons authority, the IRS has broad investigatory powers to determine the correct tax liability of any person. As this Court noted in *United States v. Arthur Young & Co.*, the summons authority "is critical to the investigative and enforcement functions of the IRS." 465 U.S. at 814 (*citing United States v. Powell*, 379 U.S. 48, 57 (1964)). But that authority is not unchecked; the summons authority remains "subject to the traditional privileges and limitations," including the protection for attorney work product. *Upjohn Co. v. United States*, 449 U.S. 383, 398 (1981) (*quoting United States v. Euge*, 444 U.S. 707, 714 (1980)).[7]

As this Court explained when it first recognized the work-product privilege in *Hickman v. Taylor*, 329 U.S. 495 (1947), "it is essential that a lawyer work with a

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tion of auditing standards issued in April 2003, the AICPA referenced this announcement, noting that "[c]oncern over IRS access to tax accrual working papers might cause some clients to not prepare or maintain appropriate documentation of the calculation or contents of the accrual for income taxes included in the financial statements, or to deny the independent auditor access to such information." AU § 9326.07.

[7] The Court's holding in *Arthur Young* does not bear on this case. This case involves a well-established privilege for attorney work product, whereas *Arthur Young* addressed whether an entirely new privilege should be created. Unlike here, the workpapers involved in *Arthur Young* were prepared by independent auditors, not by the company's counsel.

certain degree of privacy, free from unnecessary intrusion by opposing parties and their counsel." *Id.* at 510. Without this protection, "[i]nefficiency, unfairness and sharp practices would inevitably develop in the giving of legal advice and in the preparation of cases for trial." *Id.* at 511. As such, the work-product privilege reflects the "strong public policy underlying the orderly prosecution and defense of legal claims." *United States v. Nobles*, 422 U.S. 225, 236-37 (1975) (internal quotations omitted). The work-product privilege generally may be overcome by a showing of substantial need, but a nearly absolute "special protection" is afforded to "the mental impressions, conclusions, opinions, or legal theories of an attorney or other representative." *Upjohn Co. v. United States*, 449 U.S. at 398-402; Fed. R. Civ. P. 26(b)(3)(B).

This case presents an ideal vehicle for this Court to consider the broad issue of the circumstances under which competing interests should outweigh the traditional protection of a counsel's mental impressions of litigation prospects. The facts of this case are representative of those faced by most companies governed by the public reporting and auditing standards described above. The district court found that Textron's tax accrual workpapers principally consist of a spreadsheet identifying "items on Textron's tax returns, which, in the opinion of Textron's counsel, involve issues on which the tax laws are unclear, and therefore, may be challenged by the IRS" and "estimates by Textron's counsel expressing, in percentage terms, their judgments regarding Textron's chances of prevailing in any litigation over those issues." Pet. App. 92a-93a. Textron used these workpapers to prepare its financial statements in accordance with GAAP. *Id.* at

93a-94a.[8] It is in order to preserve fairness in our judicial system by shielding precisely this kind of an analysis from compelled disclosure to an adversary that the work-product privilege was created.

There is no countervailing need for the IRS to have access to these workpapers that conceivably outweighs a company's interest in keeping its counsel's evaluation of litigation hazards out of the hands of its adversary. Apart from revealing a taxpayer's hazards assessment and thereby providing a tactical advantage, the tax accrual workpapers actually provide little information that will help the IRS make a determination of the correctness of a taxpayer's return. As the district court noted here, that determination "must be based on *factual* information, none of which is contained in the workpapers." *Id.* at 118a. Rather, Textron's tax accrual workpapers contain counsel's assessment of its prospects of prevailing on legally uncertain positions and "explain the legal rationale underpinning Textron's views of its litigation chances." *Id.* at 33a (Torruella, J., dissenting). As such, the workpapers reflect the kind of mental impressions and self-evaluation entitled to the highest degree of protection under the work-product privilege.[9]

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[8] Tax reserve amounts derived from its tax accrual workpapers were aggregated with other non-tax contingent liabilities and reported as "other liabilities" on Textron's financial statements. *Id.* at 94a.

[9] The law elsewhere recognizes the need for a sharp divide between facts and mental impressions in situations where a company's relationship with the government both demands transparency and is potentially adversarial. For example,

The integrity and fairness of our tax system relies in significant part on the willingness of all taxpayers to comply voluntarily with their tax reporting obligations. *See United States v. Arthur Young & Co.*, 465 U.S. at 815. But it does not follow that a company's litigation adversary should be able to use its governmental summons authority to obtain assessments of litigation prospects prepared by the company's counsel. As the dissent below correctly noted, an IRS audit is not necessarily adversarial, but it may become acutely adversarial and is likely to lead to litigation when a disagreement over the correct treatment of a material item arises – the very kind of dispute anticipated and evaluated in a company's tax accrual workpapers. Pet. App. 39a-40a. Further, the court of appeals' effort to justify its decision by asserting that the IRS confronts "practical problems . . . in discovering underreporting of corporate taxes" (*id.* at 20a), is unpersuasive. The IRS has many useful ways of obtaining the information necessary to audit corporate tax returns without having to rely upon attorney work product that consists of the mental impressions of a company's own counsel.

An IRS summons – or merely the implicit threat of such a summons – is a powerful tool enabling the IRS to investigate facts necessary to determine a com-

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the Truth in Negotiations Act (TINA) requires government contractors to provide extensive "cost and pricing data" to the government when negotiating a contract. 10 U.S.C. §§ 2306(f), 2306a. The statute makes clear, however, that the term "cost or pricing data" is limited to facts and "does not include information that is judgmental." 10 U.S.C. § 2306a(h)(1).

pany's tax liability, even when limited by claims of work-product privilege. Indeed, as the district court here noted, the IRS typically gathers relevant information from corporate taxpayers such as Textron using informal "information document requests" (IDRs) without ever resorting to its summons authority. *Id.* at 90a. The IRS issued more than 500 IDRs in the audit in which this dispute arises, and Textron responded to each of those IDRs save the ones that requested its tax accrual workpapers. *Id.* at 91a. In addition, large corporate taxpayers are required to submit as part of their annual income tax returns detailed information explaining differences between their reported taxable income and their book net income, a frequent area of inquiry by IRS auditors. *See* Form 1120, Schedule M-3. These additional mandatory disclosures were intended to increase transparency in corporate tax returns. Press Release, Treasury and IRS Unveil New Tax Form for Corporations (Jan. 28, 2004), 2004 TNT 19-16 (Jan. 29, 2004). Further, Congress and the IRS have imposed special reporting obligations, including penalties for noncompliance, with respect to suspected tax shelter transactions. *See* 26 C.F.R. § 1.6011-4 (disclosure of participation in reportable transactions); 26 U.S.C. § 6662A (enhanced penalties for understatements attributable to undisclosed reportable transactions); 26 U.S.C. § 6111 (report of reportable transactions by material adviser). Indeed, the transactions that triggered the issuance of the summons in this case were disclosed to the IRS pursuant to these reporting requirements. C.A. App. 14-16, 254.

A holding that Textron's tax accrual workpapers are protected attorney work product would not undermine the government's ability to secure relevant taxpayer

information through its summons power or other means. On the other hand, the court of appeals' decision that Textron's accrual workpapers are not "work product" would be very damaging to the operations of a company's business. It would expose an attorney's mental impressions not only to the IRS but also to private parties who are potential adversaries in all kinds of litigation that a company and its auditor are required to assess in preparing accurate financial statements.[10]

This Court has emphasized that the work product "doctrine is an intensely practical one, grounded in the realities of litigation in our adversary system." *United States v. Nobles*, 422 U.S. 225, 238 (1975). The material in question here is core work product – namely, "the mental impressions, conclusions, opinions, or legal theories of [an] attorney . . . concerning the litigation"

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[10] As the dissent observed (Pet. App. 31a), the IRS has successfully argued for work-product protection when a potential litigation adversary seeks similar documents. In *Delaney, Migdail & Young, Chartered v. IRS*, 826 F.2d 124, 127 (D.C. Cir. 1987), the IRS invoked the privilege to resist disclosure of documents that "advise[d] the agency of the types of legal challenges likely to be mounted against a proposed program, potential defenses available to the agency, and the likely outcome" – a description not materially different from the workpapers here. The majority's suggestion that these documents "were unquestionably prepared for potential use in litigation" (Pet. App. 18a & n.9) is entirely without foundation. The quoted language concerning "crafting its legal case" refers to the potential plaintiffs seeking the documents, not, as the majority suggests, to the IRS attorneys who prepared the documents.

– for which the law provides special protection even when the standards have been met for disclosure of other work product material prepared in anticipation of litigation. Fed. R. Civ. P. 26(b)(3)(B). That special protection is necessary to provide "a privileged area within which [an attorney] can *analyze* and prepare his client's case." *Nobles*, 422 U.S. at 238 (emphasis added). The government nonetheless seeks disclosure of those mental impressions and analysis to the IRS for assistance in litigating a tax dispute against Textron – that is, disclosure to the very adversary and for the very purpose from which the work-product privilege is supposed to provide a shield. *See* Pet. App. 31a, 33a (Torruella, J., dissenting) (noting the IRS's admission that its purpose in requesting the workpapers is to obtain a tactical advantage in resolving its tax dispute with Textron). Approving that result would be the exact opposite of applying a "practical" approach to the work-product privilege. Accordingly, it is important that this Court grant certiorari to review the court of appeals' decision and to correct the erroneous undermining of a company's ability to protect its counsel's work product.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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